SCB Economic Intelligence Center

Note by EIC

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Syria tension...the effect on oil market

The increasing hostility in Syria severely fluctuated oil prices during August, as opposed to stable oil prices in quarter 2 while prices moved in a narrow band, because oil supply was able to balance with demand. The US bluntly accused the Syrian government of launching chemical weapons against innocent civilians, which violated humanitarian rights, and as a result the US could use military force to deal with the situation. If a Syrian war is to happen and expands into the Middle East, Brent prices could spike to a rate as high as 125-150 USD per barrel lifting retail oil price and inflation rate in Thailand.

The latest sharp rise in oil price is attributed to the situation in Syria. The extension of hostility in Syria caused crude oil prices to rise by more than 15% over the past 3 months. The Syrian conflict has now become an international affair with various oppositions wanting to punish the Syrian government for its August 21 chemical attack near Damascus, which killed 1,429 citizens, 426 of which were children. Worries of military force against Syria especially from the US caused the oil market to panic and spiked crude oil prices. Brent prices increased by 9 USD per barrel within 3 weeks since early August or to 118 USD per barrel, meanwhile, WTI prices increased to a 2-year high or to 110 USD per barrel. However, crude oil prices started to decline during early September after the good news that an imminent U.S. attack on Syria appeared less likely as President Barack Obama will wait for congressional authorization before striking on Syria.

Syria is not a major oil producer; hence, the oil price increments were not due to fundamental factors but more sentimental. When compared the scale of oil production, Syria produces similar levels of crude oil as Thailand or at 0.4% of world's total crude oil production. Unrests in Syria was prolonged throughout the past 2 years from conflicts between President Al-Assad and his oppositions, in which more than 100,000 citizens were already victims of the hostility. During 2011, various developed countries sanctioned Syria for its aggression, causing its crude oil production to reduce severely from its peak production at 582,000 barrels per day in 1996 to 157,000 barrels per day in 2012, which is a rate insufficient for domestic demand. Hence in 2012, Syria became an oil importing country. Since Syria is no longer active in the oil market after western sanctions, the fear in the oil markets is not caused by Syrian resources itself but by the possible impact of any military action that might expand throughout the Middle East; a continent of the world's largest oil producers.

If the US were to attack Syria, there could be a short-term Brent price spike to a rate as high as 125 USD per barrel. President Obama pushes hard to attack Syria, despite the oppositions from the public at large. Obama cites on threat to the national security as chemical weapons could be in the hands of terrorists. Obama is confident that the congress will authorize the Syrian strike plan, in which the attack will be limited and there will be no boots on ground such as during the war in Iraq and Afghanistan. However, if there are clear signs of striking Syria, Brent prices could spike to 125 USD per barrel. Furthermore, if the attack expands to neighboring major oil producers in the region especially Iraq, world's top 10 oil producers, Brent price could surge to 150 USD per barrel. However, the spike in oil prices will only be a short-term effect as the OECD countries will release a Strategic Petroleum Reserve (SPR) to alleviate global oil supply shocks.

Higher oil prices will in turn affect domestic gasoline prices and the inflation rate. Thailand is an oil importing country in which more than 80% of crude oil needs to be imported. Most of the crude oil in Thailand is used in the refining business in order to refine to petroleum products such as benzene and diesel. Hence, high oil prices from the attack on Syria could cause retail oil prices to increase by 3-4 Baht per litre, which will also affect logistics costs and product prices. SCB EIC expects that Thailand's average headline inflation in 2013 will increase by 0.2-0.5% to 2.5%-2.8%, in the case of war rising crude oil prices to 125-150 USD per barrel.

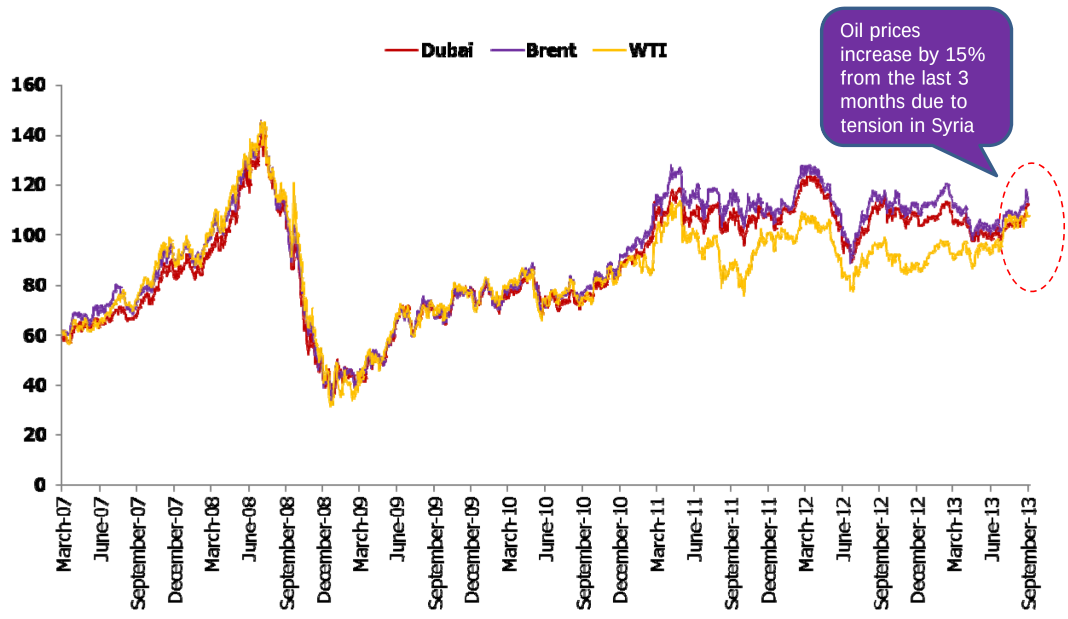
Implication

- **Oil refining companies and domestic oil traders should increase oil reserves to reduce risks from oil supply shocks.** Under clause 7, Thai refining companies and oil traders are mandated to have legal oil reserves at least 5% of total oil used throughout the year or equivalent to 36 days. If the Syrian situation is prolonged and its hostility starts to affect the world's oil supply, oil refining companies and traders should increase its reserve to a level that can at least support domestic consumption.

- **Higher inflation rate will hamper domestic consumption; meanwhile, interest rate reductions cannot be applied as a monetary tool to stimulate the economy.** It is likely that there will be a slowdown in private domestic consumption growth in 2013, expected at 3% compared to the 6.5% growth in the year before. If prices of goods further increase, consumption and private spending will continually decline. Furthermore, rapid increase in inflation rate is hard to be offset by interest rate reduction to stimulate the economy. The aforementioned factors will have a negative impact on Thailand's economic growth.

Figure 1: Syrian situation and fear of military action against Syria have affected the fluctuation in crude oil prices

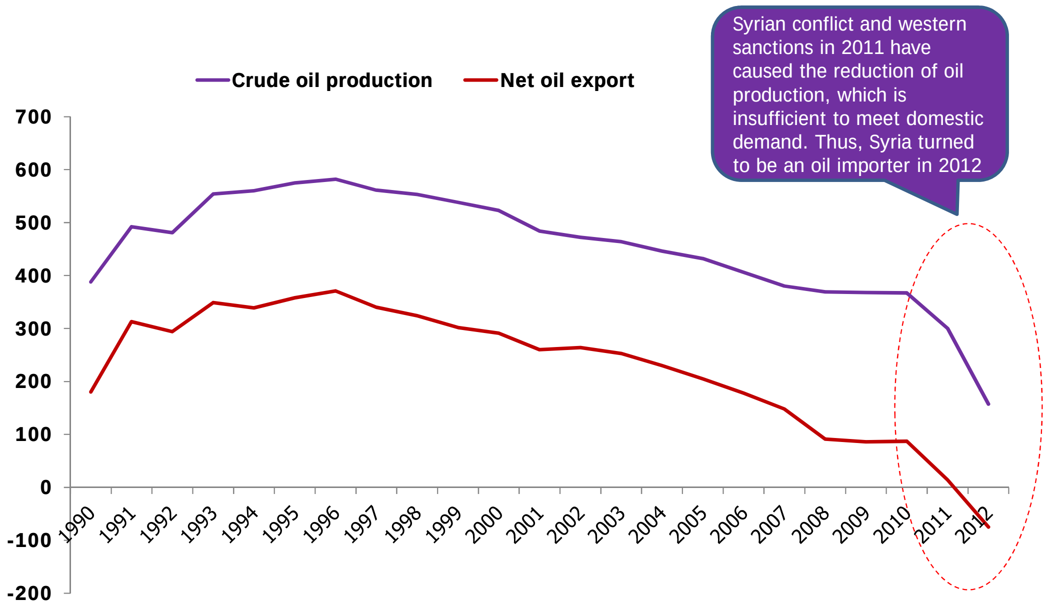
Unit: USD/Barrel



Source: EIC based on data from Bloomberg

Figure 2: Syria's oil production and export significantly dropped after the western sanctions in 2011

Unit: thousand barrels per day



Source: EIC based on data from EIA

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